ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Pacheco | Analyst: Kristina E. North | Bill Number: AB 2533

Related Bills: None | Telephone: 845-6978 | Amended Date: May 9, 2000

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Prescription Drug Credit/FTB Report Annually to Legislature Regarding Use of Credit

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _______________________.

_____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ___________ STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would allow a credit equal to 25% of the costs paid by a qualified taxpayer for prescription drugs. The credit would be limited to $300 for an individual and $600 for a married couple filing jointly.

SUMMARY OF AMENDMENT

The May 9, 2000, amendment replaced the 100% deduction for costs paid for prescription drugs with the credit discussed in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

Current federal law, to which **state law** conforms, specifically allows a deduction for unreimbursed medical care expenses, including costs for prescription drugs or insulin, as an itemized deduction, but only to the extent that the expenses exceed 7.5% of the taxpayer's adjusted gross income (AGI). "Prescribed drug" is defined as a drug or biological that requires a prescription of a physician for its use by an individual.

This bill would establish a credit equal to 25% of the costs paid by a qualified taxpayer for prescription drugs. The credit is limited to $300 for an individual and $600 for a married couple filing jointly.

Board Position:			Department Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Gerald H. Goldberg	6/22/00
_____ N	_____ OUA	__X__ PENDING		

This bill would define "qualified taxpayer" as an individual who is 65 years or older by December 31 of the taxable year and has an AGI of $20,000 or less. For a married couple filing a joint return, **this bill** specifies that *both* individuals must be 65 years or older and have an AGI of $40,000 or less.

This bill would require that a licensed physician prescribe the prescription drugs and that the taxpayer retain the sales receipts as proof of purchase of the drugs.

An individual who was a member of a health maintenance organization (HMO) or other licensed health care facility for at least six consecutive months during the 2000 calendar year or any taxable year thereafter may not claim this credit.

This bill would provide that the credit be in lieu of any deduction or credit to which the taxpayer would otherwise be entitled to claim for the same expenses.

This bill would provide that the taxpayer may carry over the excess credit for eight years, until exhausted.

This bill requires the Franchise Tax Board (FTB) to annually report to the Legislature, to the extent data are available, the use of this credit, including the number of taxpayers claiming the credit, the total and the average values of the amount of the credits claimed. The report also shall include any other information that the members of the FTB think would be of assistance to the Legislature in determining the effectiveness of the credit in helping offset the cost of prescription medication for low-income and moderate-income seniors.

Policy Considerations

This bill does not disallow the credit for prescription expenses reimbursed by an insurance carrier; however, it does disallow the credit for a taxpayer’s co-payments for prescriptions if the taxpayer is a member of an HMO or other health care facility for at least six months. Thus, this bill appears inconsistent in its treatment of similar expenses. The author may wish to make the treatment of expenses consistent.

The calculated average credit per qualified taxpayer is estimated to be approximately $151 (or half of the proposed maximum credit per individual). Targeted taxpayers would likely not have enough tax liability to utilize this credit to the $300/$600 maximums. The author may wish to consider a more direct method of providing the desired relief.

For a married couple filing a joint return to qualify for this credit, this bill would require that *both* spouses be age 65 or older by December 31 of the taxable year. If only one spouse meets this criterion, neither spouse would qualify to claim this credit on a joint return. To claim the credit, the qualified spouse could file a married filing separate return. However, the author may wish to condition the limitation per individual to allow the couple to claim up to a $300 credit for the spouse who is 65 or older by December 31 of the taxable year.

Implementation Consideration

To ensure the author's intentions are achieved and to minimize disputes with taxpayers, a definition of "prescription drugs" is needed. The author may wish to consider using the federal income tax law definition of prescription drugs. In addition, the bill denies the credit to “members of a health maintenance organization or other licensed health care facility.” The meaning of these terms is unclear. Definitions or revisions to the terms to clarify their meaning would reduce or eliminate ambiguity and disputes between the department and taxpayers.

Department staff is available to assist the author's office in the resolution of this and any other issue.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact departmental costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 2533 As Amended May 9, 2000 Enactment assumed after June 30, 2000 [$ In Millions]		
2000/2001	2001/2002	2002/2003
-$6	-$5	-$5

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The amount of prescription drug costs incurred by qualified taxpayers and the amount of other credits that could be applied to reduce tax liabilities will determine the revenue impact of this bill.

Based on household spending data for 1997, the average annual out-of-pocket expenditure for prescription drugs for individuals age 65 or older was projected at approximately $605 for 2000. Multiplying projected prescription drug costs by the proposed credit percentage of 25% derived an average credit per individual of $151 in 2000, increasing to $197 in 2004. The calculated average credit ($151 for single individuals and $302 for individuals married filing jointly) was considerably less than the proposed maximum of $300/$600 (single/joint).

A simulation was performed using personal income tax sample data. The senior exemption credit was increased by the average credit calculated above for taxpayers with AGI of $20,000/$40,000 or less (single and head of household/joint). Assuming each qualified taxpayer in the sample generated the average credit, the simulation models the maximum revenue loss to the extent credits generated could be applied to reduce tax liabilities. Reduction adjustments were made to the model result to allow for the following:

1) to eliminate taxpayers who are married filing joint where only one individual was age 65 or older;

2) to eliminate any ineligible taxpayers who were members of an HMO or other licensed health care facility for at least six consecutive months during the year;

3) for a small portion deducted under current law as a medical expense (subject to the 7.5% of AGI threshold); and

4) to reflect the rate at which qualified taxpayers would report the credit on their tax returns.

BOARD POSITION

Pending.